UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

VONAGE HOLDINGS CORPORATION, Plaintiff, -against- THE NEW YORK STATE PUBLIC SERVICE COMMISSION, and WILLIAM M. FLYNN, LEONARD A. WEISS, THOMAS J. DUNLEAVY, and NEAL N. GALVIN in their official capacities as the Commissioners of the New York State Public Service Commission and not as individuals, Defendants.	04 Civ. No. _____ **DECLARATION OF JOHN REGO**

1. My name is John Rego. I am over the age of 18 and competent to provide the testimony herein.

2. I have been employed by Vonage Holdings Corp. ("Vonage") as Chief Financial Officer since July 2002. I have extensive operational and management experience in both telecommunications and Internet-related industries. Prior to joining Vonage, I was Vice President of Finance for business operations at RCN Corporation from 2001 to 2002. RCN is a provider of local telephone and Internet services that competes head-to-head with incumbent telephone and cable companies such as Verizon and Time Warner. Prior to RCN, I spent 3 years at Winstar Communications in a variety of corporate and operational finance positions, including as Vice President of Finance for the General Business, Internet, Web Hosting and Professional Services divisions. Winstar is also a competitive telecommunications services provider, focusing on business customers. Prior to joining the communications industry, I spent over 14 years in

practice as a certified public accountant with international CPA firms. I hold a bachelor degree in accounting from Rutgers University. I have personal knowledge of the facts set forth herein.

A. Vonage's Service

3. Vonage provides a service called DigitalVoice™ that enables its customers to have oral communications over the Internet that seem like ordinary telephone "calls".[1] Unlike traditional telephone service users, Vonage customers do not use telephones connected to the Public Switched Telephone Network ("PSTN") operated by local telephone companies, such as Verizon, the incumbent local exchange carrier ("LEC") in most of New York. Vonage customers can only access Vonage's service over the high-speed ("broadband") Internet connections provided by third-party cable modem, DSL, satellite, and other Internet Service Providers ("ISPs"). Vonage does not provide Internet access service. Voice communications to and from Vonage customers are routed over the Internet in the form of digital packets in Internet Protocol ("IP") standard used on the Internet.

4. Vonage describes itself as the "Broadband Phone Company" but it does not actually provide phone service. Rather, the core service provided by Vonage is a translation or protocol conversion service that allows communications between users of the incompatible and unconnected networks of the Internet and the Public Switched Telephone Network ("PSTN"). Since consumers are accustomed to having oral communications by telephone, Vonage's service is designed to simulate phone service in order to enhance customer comfort. For instance, special equipment or software that a customer must own to access Vonage's service simulates dial tones

[1] As the author of the most popular telecom dictionary explains, "[e]veryone has a different definition for 'call.'" Harry Newton, *Newton's Telecom Dictionary* (15th Ed 1999) at 127 (definition of "call"). I use the term here to describe voice communication made possible by electronic equipment.

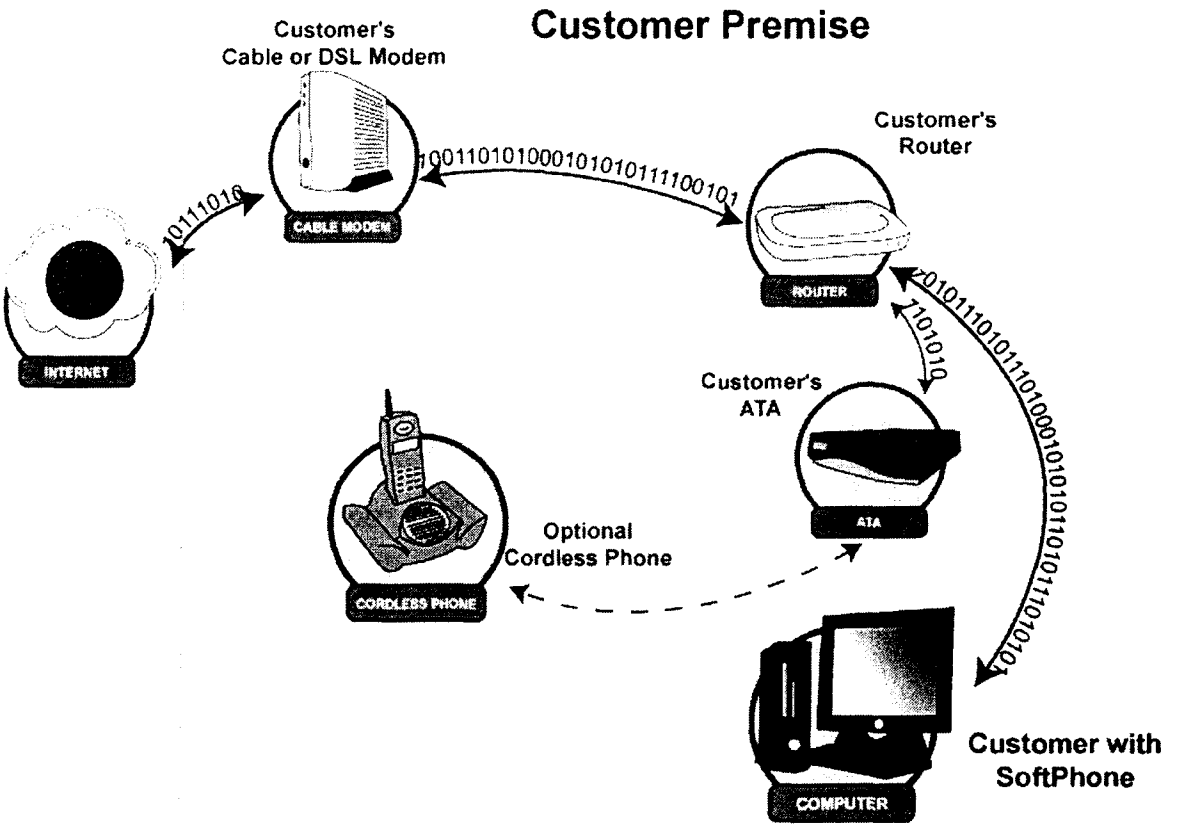
and dialing sounds which are otherwise absent when communications are conducted over the Internet. Further, as I explain more fully below, Vonage customers are associated what appear to be traditional ten-digit telephone numbers even though those numbers actually translate into the IP address of the customer's portable computer equipment rather than the geographic location of a home or business telephone connected to the PSTN.

5. Voice Over Internet Protocol or "VoIP" is the generic term that describes the routing of voice "signals" over the Internet. VoIP does not describe any particular kind of service or technology. There are other providers of VoIP telephony whose service is configured and provisioned very differently from Vonage's.

6. Vonage customers must purchase special computer software and/or equipment that permits them to place and receive communications over these broadband connections. This equipment cannot be used to make phone calls from a telephone connected to the PSTN. The necessary equipment includes a device called an Analog Telephone Adapter ("ATA"). The ATA is a computer that converts analog voice signals into IP. Customers may procure ATAs from third party vendors or, as an inducement to subscribe to its service, Vonage will provide one ATA device to a customer for free. Currently, there are two types of ATA devices that are most frequently used by customers to access Vonage service – the Cisco ATA-186 (made by Cisco) or the Motorola VT1000v (made by Motorola). Customers can purchase these devices from other vendors – in fact, I have seen many Cisco ATAs offered for sale on eBay. If Vonage provides the ATA to its customer, Vonage does not retain ownership of the device. Rather, the customer takes ownership and assumes responsibility for proper maintenance and operation of the device and, in the event that the device breaks down (after a limited 30 day warranty supplied with the device), the customer must procure repair or replacement at his or her own cost.

7. Instead of using an ATA device, a customer may purchase and download on to his or her computer certain software known as a "softphone." This software allows any personal computer to access the Vonage service, using the audio input and output jacks built in to the computer. Customers may purchase the Xten X-Pro softphone (made by Xten) or the softphone made by SJ Labs, either directly from Vonage or from third party vendors. Softphone software can be downloaded to any computer device, including a Personal Digital Assistant ("PDA") like a Pocket PC. As with the ATA, the softphone is the property of the customer, who has responsibility for its proper operation and for repair or replacement in the event of malfunction.

8. To access Vonage's service, a customer's computing equipment can be configured in many different ways. Two possible configurations are illustrated below:



9. In the first configuration, the customer has purchased and installed a router, which is plugged directly into the Internet access modem provided by the ISP. The customer's ATA converts the customer's outgoing analog voice signals into Internet Protocol ("IP") packets and converts incoming IP packets into analog voice signals, thus facilitating a two way oral communication using the Internet. Although a Vonage customer can attach a conventional telephone handset to the ATA and speak in to the handset, a customer can just as easily use the speakers and microphones installed in her home computer (demonstrated by the second configuration illustrated above, "Customer with Soft Phone"). In either case, these devices alone cannot be used to access Vonage's Internet-based service – the customer must have a high-speed connection to the Internet as well.

10. As the diagram indicates, the customer's ATA or softphone converts the electronic voice signals generated by the telephone handset or computer microphone into IP data "packets" (indicated as "1s" and "0s" in the diagram). Thus, all customer communications leave and enter the customer's premises in IP format and are transmitted over the third-party ISP's broadband Internet connection, and on the public Internet to or from one of Vonage's Internet servers where Vonage's service is performed. The Internet data packets that comprise communications from and to Vonage customers are indistinguishable from other Internet traffic, such as those carrying e-mail, chat, instant messaging, or other communications to and from servers on the World Wide Web.

11. Vonage customers can communicate directly with other Vonage customers on the Internet (just like e-mail or instant messaging), and with customers of some other VoIP services offered over the Internet. Such communications are known in the industry as "computer-to-computer calls" and never leave the Internet. Vonage customers' computer-to-computer calls are similar, albeit with some functional differences, to the Free World Dial-up service that a company called Pulver.com offers, as that service was described in the FCC's recent *Pulver.com* order.[2] Approximately 3 percent of all Vonage calls are computer-to-computer, and we expect this figure to rise as more and more consumers abandon traditional telephone service.

12. Vonage also offers a service that allows its customers to communicate with plain old telephone service ("POTS") users on the PSTN.[3] These "computer-to-phone" communications

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[2] *Petition for Declaratory Ruling that Pulver.Com's Free World Dialup is Neither Telecommunications nor a Telecommunications Service*, 19 F.C.C.R. 3307 (2004).

[3] "Plain Old Telephone Service" typically refers to customers using traditional wired voice telephone service. Actually, our service allows our customers to communicate with any telephone device that has a telephone number, including wireless phones, fax machines, and other equipment. For purposes of the conversions I will describe, however, it does not matter

are serviced in one of two ways. If the communication is initiated by a Vonage customer over his or her Internet connection and directed to a PSTN user, then the IP data packets associated with the customer's conversation are sent, via the customer's broadband Internet connection, over the Internet to one of Vonage's Internet servers. Vonage currently operates three such servers around the country, including one in New York City. These servers are functionally similar to any other server computer on the Internet.

13. Data packets received by Vonage's Internet server are then routed to a special Vonage computer that transforms the IP data packets sent by the customer into the format (also known as "protocol") of the PSTN (known as "TDM" – the acronym for "time division multiplex" – which is a technique for transmitting a number of separate signals simultaneously over one, shared communications line). Vonage's special computer then "hands" the communication to a regulated telephone company (either a long-distance carrier or a local exchange carrier, depending on where Vonage's server is located and the communication is being directed) via dedicated lines that the carrier provides to Vonage.[4] This carrier retrieves the communication, transmits it in TDM format over the PSTN, and then "terminates" the call to the PSTN end-user, thus establishing the connection between Vonage's Internet customer on the Internet and the POTS end-user's telephone on the PSTN.

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what service is at the non-Vonage end of the call, as long as it is accessible through the Public Switched Telephone Network.

[4] Vonage "hands off" communications to competitive local exchange carriers ("CLECs") in communities where Vonage is a customer of such companies. When calls are directed to end-users in communities where Vonage has no such customer relationships, communications are "handed-off" to long-distance carriers (technically known as "interexchange carriers," or IXCs).

14. If the communication is initiated by a non-Vonage customer on the PSTN to a Vonage customer on the Internet, the service works somewhat differently because PSTN users can not dial Internet IP addresses which are necessary to determine the "destination" of Internet communications. Vonage's service allows the PSTN user to dial what appears to be an ordinary 10-digit telephone number in order to place a "call" to a Vonage customer. Vonage obtains these ten-digit telephone numbers from regulated telephone companies in its capacity as a customer of those telephone companies, just like any large corporation or end-user. These numbers are then associated by Vonage to the IP addresses of its customers' computers on the Internet. IP addresses are not geographically assigned, but are allocated to the operators of computer networks (such as Internet service providers). An ISP can assign any of its IP address numbers to any of its users, regardless of location, and many ISPs assign these numbers "dynamically" so that the same customer can be assigned a different address each time they log on to their account. Also, a customer with a laptop or other portable computer can attach it to a different broadband connection at any time, thereby obtaining a new IP address for the duration of that connection. Thus, each time an ATA or softphone is activated, it signals Vonage's server and provides the IP address at which it is located *for the time being*. Vonage then stores this information in a database so that, when an inbound call is received on the telephone number associated with that equipment, signals can be transmitted over the Internet to the correct IP address.

15. As a consequence, the telephone number that Vonage associates with the IP address of a customer's computer is not associated with a physical address or geographic location. The telephone numbers of Vonage customers are "virtual numbers" only. This feature allows Vonage customers to obtain telephone numbers with "area codes" of their choosing. By contrast,

ordinary telephone service involves assignment of telephone numbers that are associated with physical addresses.

16. When an end-user on the PSTN places a call to a phone number assigned to a Vonage customer, the communication is transmitted over the facilities of the PSTN user's local carrier to a Competitive Local Exchange Carrier or CLEC (a regulated telephone company) that provides telecommunications services to Vonage. From the CLEC's perspective, the phone number dialed by the end user is one assigned to Vonage and, as a result, the CLEC transmits the PSTN user's communication to Vonage where it is delivered to a Vonage media gateway server. There, Vonage's media gateway server converts the content of the communication from the TDM format it receives into IP format for transmission on the Internet, and identifies the IP address associated with the computer of the Vonage customer to whom the communication is directed. To do this, Vonage populates and operates databases that allow for the instantaneous translation of the 10-digit "telephone number" into the IP address associated with the customer's computer. The Internet data stream is then routed by Vonage's server to the customer's IP address, via domain name system ("DNS") look-up functionality, in order for the communication to be sent over the Internet to the proper Vonage customer's computer and ATA or softphone.

17. Because Vonage's "virtual numbers" are associated with IP addresses and not geographic locations, Vonage customers can have numbers associated with communities other than their own. For example, a resident of New York City who would be assigned a PSTN telephone number beginning with the "212" area code can, under Vonage's service, be assigned a telephone number beginning with the "202" prefix associated with Washington, D.C. or the "213" area code associated with Los Angeles. Likewise, residents of these other communities can request a "212" or "646" number associated with Manhattan. Moreover, Vonage customers

can use these virtual numbers to engage in communications from any location that a broadband Internet connection is available. Thus, while a Vonage customer's computer may have a "212" area code, she can take her portable computer and ATA with her to Tampa, Florida and, over a broadband Internet connection there, can make and receive telephone calls from and to her "212" telephone number.

18. Vonage offers its service on an unlimited use basis or in packages which describe use as "local," "regional" or "long distance" calls.[5] However, since the telephone numbers with which Vonage customers' computers are associated have nothing to do with geographic location, whether a communication is billed as "local," "regional" or "long distance" is not dependent on the geographic location of the Vonage customer and the party with whom she is communicating. Instead, under Vonage's service contracts, for customers who choose service packages that distinguish between "local and regional" or "long distance" calls, the characterization for billing purposes depends solely on the telephone number assigned to the Vonage customer's computer and the telephone number of the other party to the communication. Thus, if a Vonage customer with a "212" area code communicates with a PSTN user in Manhattan, that communication will be billed by Vonage as a "local" call, even if the customer is in Los Angeles when she initiates the communication. Conversely, if a customer with a Washington, D.C. area code uses a high speed Internet connection in Manhattan to communicate with a PSTN user in Manhattan, that communication will be billed by Vonage as a "long distance" call.

19. Because Vonage customers access the service over the Internet, Vonage cannot determine its customers' actual physical location when they use its service. Thus, Vonage cannot

[5] Under Vonage's service contracts, "local" and "regional" calls fall into the same billing category. We use both terms in our marketing materials due to customer familiarity with them.

determine the jurisdictional nature of its customers' traffic – *e.g.*, whether calls are jurisdictionally "intra-state" (defined as calls between end-users in the same state), "inter-state" (defined as calls between end-users in different states), or "international."

20. Vonage's virtual numbering capability has proved enormously popular. Of its 32,649 "New York customers" (as of May 27, 2004), only 24,864 (or 76 percent) had *both* New York telephone numbers *and* billing addresses. Of the remaining 24 percent of customers, 4,889 have chosen New York numbers but have non-New York billing addresses, and another 2,896 have New York billing addresses but have chosen non-New York numbers.

21. Vonage customers provide billing addresses for credit card validation purposes only. Vonage communicates with its customers via e-mail and sends no paper bill. Billing address are, therefore, only a proxy for its customers' physical residences but not their actual physical locations. Since the computers used to access Vonage's Internet service can be smaller than a lap top computer, and are therefore portable, Vonage customers can access the service from anywhere in the world with access to a high speed Internet connection. *See, e.g.*, John C. Dvorak, "Free Phone Calls," *PC Magazine*, July 2003 (describing how one Vonage customer used the service with a California telephone number while staying at a hotel in New York City) (attached hereto as Exh. A).

B. The New York Public Service Commission Order

22. The New York PSC ruled in its order ("PSC Order"),[6] that Vonage "is a 'telephone corporation' as defined" by New York law and further found that state regulation of Vonage is not preempted by federal law. PSC Order at 2.

23. The PSC Order states that

> Vonage owns and manages equipment (a media gateway server) that is used to connect Vonage's customers to the customers of other telephone corporations via their public networks, as necessary. This equipment constitutes a "telephone line" under the PSL and is used to facilitate the provisioning by Vonage of telephonic communication to customers. Accordingly, Vonage is a "telephone corporation" under our jurisdiction.

PSC Order at 10. The PSC's Order further states that Vonage's gateway servers are just "special router[s] that connect[] an IP network to a traditional telephone network." *Id.* at n.11. This is incorrect. Vonage's servers are just like other Internet servers, but they also provide certain data processing functions that are unique to Vonage's service. The servers first establish an Internet connection with the Vonage customer and then authenticate the customer's right to access the service. This process involves querying various Vonage databases, and potentially re-routing the transmission to the appropriate server for servicing the communication.

24. Further, as its name indicates, the Vonage server is the access point to Vonage's service – the protocol conversion process. The server routes the IP packets generated by Vonage's customers to a protocol processor which then converts the IP data stream into the

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[6] *Order Establishing Balanced Regulatory Framework for Vonage Holdings Corporation*, Complaint of Frontier Telephone of Rochester, Inc. Against Vonage Holdings Corporation Concerning Provision of Local Exchange and InterExchange Telephone Service in New York State in Violation of the Public Service Law, Case No. 03-C-1285 (N.Y. PSC May 21, 2004) (Attached as Exhibit B).

TDM format used on the PSTN. This net protocol conversion is not a service supplied by ordinary telephone companies on "telephone lines." After its conversion service is performed, Vonage "hands off" the communication to its telecommunications vendor and only then is the call carried on the PSTN and terminated by the telecommunications vendor who is subject to telephone regulation. Notably – and again contrary to the PSC's Order – *Vonage* is not connected to the PSTN. Vonage is the customer of telecommunications companies that are connected to the PSTN, but Vonage, itself, is not so connected. The PSC also mischaracterizes the nature of Vonage's relationship with its telecommunications providers, contending that Vonage is a "reseller" of "capabilities it acquires from the other, third party, telephone corporations." Vonage does not resell telecommunications services – it merely uses them as a customer in its own right as a means of effectuating its service, just as do thousands of other internet information service providers. As the PSC has used the term "reseller" here, any firm that uses the telecommunications services of another company to provide a value-added information service would be a reseller. For example, dial-up ISPs, such as AOL, use local carriers to terminate their Internet traffic, yet AOL is not considered a reseller of telecommunications service by the FCC or state regulators.

25. In claiming that Vonage's service is a telecommunications service rather than an information service under federal law, the PSC Order states that: "A Vonage customer's voice is transmitted between or among points specified by the customer, without any change in the form or content of the conversation." PSC Order at 12. The PSC is wrong. First, Vonage's service *does* make a "change in the form or content of the information as sent and received." Vonage customers send their communications to Vonage over the Internet in the form of IP packets and Vonage converts the IP packets into the TDM format used on the PSTN (and vice versa).

26. Second, Vonage's service does *not* transmit information "between or among *points* specified by the user." *See* 47 U.S.C. § 153(43). Rather, Vonage only routes traffic to IP addresses on the Internet, not from and to specific points. *See* The American Heritage College Dictionary (3rd Ed. 1997) at 1055 (defining "point" as "[a] place or locality considered with regard to its position ... a narrowly particularized and localized position or place; a spot"). As noted previously, Vonage cannot determine whether its customers are located in Timbuktu or Tennessee, much less transmit information to "a narrowly particularized and localized position." In the case of a computer-to-computer call, *neither* user can specify the "point" at which the other is located.

27. The PSC Order also states that Vonage "does not offer its customers a capability to manipulate or interact with stored data." PSC Order at 12. This, too, is wrong. Vonage must query databases, and thus "interact with stored data" in order to correlate the IP addresses associated with each Vonage customer's 10-digit "telephone number."

28. The PSC wrongly contends that Vonage's service involves no net protocol conversion because: "[Vonage's] adapter and/or software convert [*sic*] its customers' speech into the Internet protocol (IP) data format. Vonage's network subsequently converts IP packets back to TDM in order to facilitate calls between its customers and other carriers' telephone subscribers." PSC Order at 12-13. First, while the adapter or softphone does convert speech into IP data format and vice versa, this equipment belongs exclusively to the customer and the conversion is performed by the customer – not by Vonage. Second, there is no "Vonage network." Rather, Vonage customers need the high-speed Internet connections provided by third-party, broadband ISPs who own and operate the network Vonage customers use to access Vonage's service on the Internet. To the extent that Vonage customers communicate with PSTN users, the PSTN is an

altogether separate network that is owned and operated by regulated telephone companies and to which Vonage is not connected.

29. Third, and finally, communications "leave" the Vonage customer's premises in IP format and are received by PSTN users in TDM format. This transformation of the format of the communication during its transmission constitutes a net protocol conversion.

30. The PSC also erroneously suggests (without explanation) that Vonage's service is "phone-to-phone IP telephony." *See* PSC Order at 13. My understanding is that the FCC first defined "phone-to-phone" IP telephony in its 1998 Universal Service Report to Congress, where it described phone-to-phone IP telephony as calls that are both originated over a "*handset connected to the public switched network*" and that are likewise terminated "to ... [an] ordinary telephone at the receiving end." *Universal Service Report* ¶ 84 (emphasis supplied).

31. Thus, phone-to-phone IP telephony is a traditional common carrier service performed by traditional common carriers using their underlying transport facilities to offer transmission with no net change in form or content. Because phone-to-phone IP telephony uses PSTN connections on both ends, every call enters the network in the same format (TDM) as it exits; the carrier temporarily converts the format of the communication, but returns it to the original format before delivery. Thus, phone-to-phone IP telephony does not produce a *net* protocol conversion characteristic of an information service.

32. Vonage's service is very different because, although Vonage customers may use ordinary telephone handsets, those devices are connected to a computer connected to the Internet, not to the PSTN. When the communication traverses the demarcation point between the customer's premises and the ISP's network, it is in the IP format used on the Internet. After the data packets reach one of Vonage's servers on the Internet, they are converted into TDM and

delivered to Vonage's telecommunications vendor for transmission and termination on the PSTN.

33. Thus, Vonage's service originates on the Internet and (in this example) terminates on the PSTN. It requires the use of special customer premises equipment with enhanced functionality (*e.g.*, a computer so that the customer can access the Internet) and provides a net protocol conversion. These characteristics make it very different from the kind of services that the FCC has defined as phone-to-phone IP telephony.

34. Further, it is not technically possible to separate Vonage's service into distinct intrastate and interstate components. *See* PSC Order at 14. As explained at length above, Vonage's protocol translation service occurs on the Internet. Further, the portable nature of the equipment used to access Vonage's service (which makes it possible for a customer to use a New York telephone number to place and receive calls in Atlanta), the very nature of the Internet itself (which functions in a "virtual" world in which physical location is irrelevant and not possible to determine), and Vonage's unique service (which assigns 10-digit "telephone numbers" without regard to an end-user's actual geographic location), makes it impossible for Vonage to determine which communications are inter-state, intra-state, or international.

35. The PSC is likewise wrong that Vonage's offering of an "Unlimited Local Plan," demonstrates that "it is not impossible to separate intrastate and interstate calls." PSC Order at 14. As explained above, "local" calling is merely a contractual fiction used by Vonage for billing purposes and has nothing to do with where parties are geographically located during a communication. Vonage charges are based on the area codes associated with its customers's computers and have nothing to do with a customer's physical location. Thus, a customer with a "212" area code assigned to her computer can use her computer from Seattle to communicate

over a broadband Internet connection with a PSTN user who also has a "212" area code. From, Vonage's billing standpoint, this would be a "local call." Vonage has no idea of, nor need to know for billing purposes, the physical locations of its customers when they use broadband Internet connections – only their IP addresses are transmitted. Importantly, if Vonage were forced to tariff rates for intra-state calls, it could not ensure compliance with the tariff because what Vonage refers to as a "local call" for purposes of ubiquitous Internet usage is not at all what state telephone regulation means when it refers to a "local call." Vonage can not determine if any particular communication from or to one of its customers occurs between geographic locations that would be local or regional or long-distance under telephone company regulation.

36. Finally, Vonage disputes the PSC's apparent conclusion that regulation is warranted because its "status" gives it a competitive advantage over regulated telephone companies and endangers the "financial[] sustainability" of the PSTN. *See* PSC Order at 16. First, Vonage is a customer of telecommunications carriers. Those carriers are subject to regulation and are required to pay all applicable fees when they use the PSTN to deliver communications to Vonage's servers and when they retrieve Internet communications from Vonage for delivery to PSTN users. I understand that under applicable law, those carriers should pay into the universal service fund based on their customers', including Vonage's, usage of service. Similarly, I understand that under applicable law, carriers handling Vonage customer communications should pay long-distance access charges and reciprocal compensation to terminate those communications on the PSTN. I have no reason to believe that the carriers from which Vonage purchases service are not actually paying these fees and charges. Thus, the notion that Vonage's service threatens the financial "integrity" of the PSTN seems to be premised on the notion that

PSTN carriers should be allowed to enhance their financial stability by "double dipping" – once from Vonage's telecommunication vendor and then again from Vonage.

C. The PSC Proceedings

37. The PSC proceeding which led to the Order arose from a Complaint that Frontier Telephone of Rochester, Inc. ("Frontier") filed against Vonage before the PSC on September 10, 2003. (The Frontier Complaint is attached as Exh. C.)

38. The complaint alleged that Vonage was providing intrastate "telephone" services in New York without the PSC's authorization, *i.e.*, in violation of the Public Service Law ("PSL"). Under New York's Administrative Procedure Act, because Frontier's complaint initiated an adjudicatory proceeding, Vonage was entitled to a hearing and to present evidence. New York Administrative Law § 301(1) and (4).

39. On October 9, 2003 the PSC issued a *Notice Requesting Comments* (the "Notice") (Exh. D). Pursuant to the Notice, Vonage filed a Response and Motion to Dismiss the Frontier complaint on the basis that, *inter alia*, Vonage provides interstate information service over the Internet with respect to which state regulation is preempted and over which state regulation, if imposed, would impermissibly burden interstate commerce.

40. On October 15, 2003, the PSC published a notice of proposed rulemaking in the NYS Register in which it described Frontier's complaint proceeding as "Definition of Telephone Service by Frontier Telephone of Rochester, Inc." (Exh. E.) The notice stated: "Because this complaint raises generic concerns that could affect a number of entities, a notice requesting comments on the complaint has been issued. The commission will evaluate the comments received and may make determinations concerning the applicability of the Public Service Law to various forms of service, including voice over internet protocol (VOIP)." Thereafter, I

understand that commission staff members John Coleman and Saul Abrams invited Vonage's counsel to meet with them and further advised Vonage counsel that there need be no concerns about *ex parte* contacts because the complaint proceeding had been converted to a rulemaking proceeding. As a consequence, Vonage counsel did meet with those commission staff members. No hearing on the Frontier complaint ever was scheduled.

41. After receiving comments and reply comments, the PSC issued its Order on May 21, 2004, effective that same date. In the Order, the PSC did not adopt any generic rules or make generic determinations regarding various forms of service, but rather made Vonage the sole focus of its Order and made certain purported findings of fact with respect to Vonage and its service, despite the facts that no hearing had been held and no evidence taken. The PSC concluded that by offering and providing its DigitalVoice™ service in New York, Vonage was a "telephone corporation" as defined in the PSL and therefore subject to state regulation. The PSC ordered Vonage to (a) obtain a Certificate of Public Convenience and Necessity ("CPCN"); and (b) file a tariff, both within 45 days of the Order (*i.e.*, by July 5, 2004). Within the Order, the PSC also permitted Vonage to seek waiver of specific rules and regulations.

D. Consequences of the PSC's Unlawful Determination

42. New York's state telephone regulation relies primarily on customer physical locations for a host of issues from tariffing to emergency calling. The imposition of such regulation on Vonage's Internet service exposes it to significant risks of uncontrollable regulatory violations and ensuing penalties because the Internet nature of its service prevents determination of its customer's physical locations. As a consequence, Vonage cannot ascertain whether its customer's communications are interstate, intrastate, local or regional in the traditional geographic sense in which state telephone regulation was crafted to apply and cannot ensure that

geographically-based tariffing is properly applied. Moreover, Vonage cannot cure this inability to comply merely by "withdrawing" its service from the State of New York because, as explained above, access to Vonage service is portable. Vonage customers with area codes from states other than New York can easily bring their computers to New York, plug in to a broadband connection and, without Vonage's knowledge, communicate with New York PSTN users. Under Vonage's billing plans, these would look like interstate "long distance" types of communications, but under telephone regulation these communications would, according to the PSC's order and notwithstanding their essential use of the Internet, be cast as "local" or intrastate communications.

43. Based on my previous experience with RCN and Winstar, I have some general understanding of how state regulation of telephone companies works, although I am not a regulatory expert. I understand that regulated telephone companies are required to file "tariffs," which are legally binding statements of the rates, terms, and conditions governing their services; and that the PSC has the authority to require changes in any terms that it finds unlawful or unreasonable. Regulated telephone companies file separate tariffs for their interstate services with the FCC (except in cases where the FCC has forborne from requiring tariffs), and for their intrastate services with state commissions. Therefore, interstate and intrastate services may be subject to different, and possibly inconsistent, legal requirements.

44. I cannot imagine how Vonage could possibly comply with the tariff requirements, given that we cannot separately identify interstate and intrastate components of our service. We could, of course, file a tariff with the PSC that is identical to the contract terms of service we offer to all our customers nationwide. Those terms, however, include a single monthly rate for the use of the service by each customer; not separate rates for intrastate and interstate use, like

typical telephone company tariffs. It is impossible for us to break down our charges in this way since we cannot measure or even identify separate categories of usage. Moreover, if the PSC requires any changes in our standard terms, we would have no way of applying those changes only to New York intrastate services, because we have no way of identifying those services. The only way we could avoid violating New York law would be to apply the modified terms to *all* our contracts and all our customers, including customers located outside New York who may not ever make a New York intrastate call. (Because, if one of those out-of-state customers stays in a hotel in Manhattan and places a call over their Vonage service to Albany, they theoretically could complain to the New York PSC if we failed to comply with some rule governing intrastate calls.) This would effectively allow the New York PSC to dictate the terms under which we offer interstate services, and even intrastate services in other jurisdictions. And, of course, if some other state imposes *different* tariff requirements, we would be put in the awkward position of having to violate either one or the other state's requirements, without ever being sure which set of requirements applied to a particular service.

45. I also understand that New York PSC regulation requires that Vonage file annual reports of intrastate revenues, operating expenses and billings. Again, since we cannot identify when our service is being used strictly for an intrastate communication, it is impossible for us to comply with this requirement.

46. It is my understanding that statutory penalties for noncompliance with regulations can be imposed at up to $100,000 a day. The existence of regulatory violations by Vonage and the imposition of any fines against Vonage for its inability to comply with regulations will have immeasurable consequences that can not be remedied by monetary compensation. Vonage's goodwill and business reputation will be damaged. Vonage's cost of business is certain to spiral

and its charges for its service will likewise have to spiral – all of which is highly likely to precipitate customer loss and threaten Vonage's viability. Lenders, investors and customers will become doubtful of Vonage's ability to maintain service in light of its inability to maintain regulatory compliance, its increased business costs and its customer loss – they are likely to withdraw their support and patronage from Vonage.

47. I have been informed that the PSC also is required by statute to review all contracts entered into by regulated telephone companies relating to their regulated services. Since the PSC believes that our Internet application is a regulated service, this statute apparently would require us to file all contracts we enter into with ISPs, telecommunications carriers, and other vendors. I believe that this requirement would make it far more difficult for us to negotiate commercially favorable contracts, since other parties would be reluctant to offer us their best terms if they expected the contracts to become public.

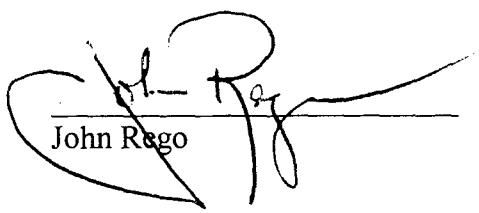
48. I also am aware that the PSC has authority over equity and debt financing of regulated telephone corporations; indeed, this is a subject that I dealt with extensively in my previous jobs. This prospect is very troublesome to Vonage. Vonage is a privately-held company that has grown through privately-negotiated debt and equity placements. If we had to obtain government approval before entering into any of these transactions, our access to capital would be impaired, as well as our ability to respond quickly to market conditions. Further, while the kind of funding Vonage has received is of short supply to start-up Internet companies in general, it is unavailable entirely to start-up regulated telephone companies in today's market. I am concerned that characterization of Vonage as a telephone company would, by itself, impair our access to financing because of the negative attitude of investors toward such companies.

49. If regulation is permitted and Vonage is prohibited from offering DigitalVoice service in New York, or is subjected to penalties for its inability to conform its Internet service offerings to geographically driven telephone regulations, Vonage can suffer irreparable harm to its business in the form of a significant loss of its customer base, loss of future financing, inability to fulfill its contracts as a customer of telecommunications carriers, loss of reputation and loss of the competitive advantage it has achieved over other providers of VoIP services.

50. No other application has been made for the relief requested herein.

Further declarant sayeth not.

I hereby affirm under penalty of perjury that the foregoing is true and correct to the best of my knowledge.



John Rego

Dated: June 7, 2004
New York, New York